

Hong Kong, China—Update

Yield Movements

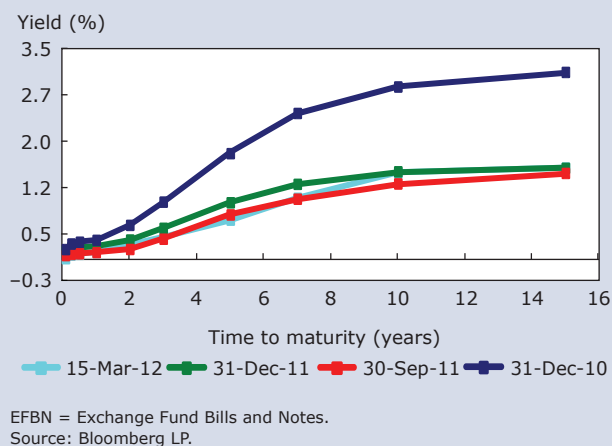
The yield curve for Hong Kong, China's Exchange Fund Bills and Notes (EFBNs) shifted significantly downward in 2011 (**Figure 1**). Between end-December 2010 and end-September 2011, the yield curve fell 73 basis points (bps) on average. The drop was greatest at the long-end of the curve, with the 10-year tenor falling 159 bps and the 15-year tenor falling 166 bps. From end-September to end-December, there was a slight shift upward in the yield curve, particularly in the middle- to the long-end of the curve. The 5-year tenor rose 20 bps while the 7-year tenor rose 24 bps. However, the end-December levels were still significantly lower than where the curve was at end-December 2010.

More recently, the yield curve fell for all maturities between end-December and 15 March, except for the 15-year tenor. The 5-year tenor declined the most, falling 28 bps, followed by the 7-year tenor, which fell 23 bps. Yields on the 10-year maturity fell only 2 bps while the 15-year tenor rose by 0.2 bps. For tenors of less than 5 years, yields fell an average of 11 bps. Due to the slightly larger drop in the 2-year rate versus the 10-year rate, the yield spread between the 2- and 10-year rate widened to 118 bps from 112 bps from end-December to 15 March.

The decline in yields reflected concerns that Hong Kong, China's economy would continue to weaken. Gross domestic product (GDP) growth in 4Q11 fell to 3.0% year-on-year (y-o-y) from 4.3% in 3Q11. During the 2011–12 Budget Speech, Financial Secretary John Tsang said that declining exports could weaken the economy, with the 2012 GDP growth rate expected to reach only 1%–3%. In January, exports fell 8.6% y-o-y, while imports fell 10.5%. In contrast, December saw an export growth rate of 7.4% y-o-y and an import growth rate of 8.1%.

In 2012, HKD80 billion will be allocated for relief and stimulus measures to help boost the economy.

Figure 1: Hong Kong, China's Benchmark Yield Curve—EFBNs



The measures will take the form of tax rebates, electricity subsidies, and property tax rate waivers.

Inflation hit a peak in January, rising 6.1% y-o-y, driven by food and housing-related expenses from 5.7% in December. However consumer price rises tapered off in February, rising 4.7%. The government plans to increase the supply of land to help stabilize property prices.

Size and Composition

The size of Hong Kong, China's local currency (LCY) bond market grew 3.1% y-o-y to HKD1.3 trillion (US\$168.5 billion) as of end-December (**Table 1**). However, on a quarter-on-quarter (q-o-q) basis, LCY bonds outstanding fell 0.9%, driven by a fall in corporate bonds outstanding.

Total LCY government bonds outstanding rose 3.9% y-o-y as of end-December, while q-o-q growth was 0.9%. Government bonds include Exchange Fund Bills (EFBs), Exchange Fund Notes (EFNs), and bonds issued under the Institutional Bond Issuance Programme (HKSAR Bonds).

The amount of LCY government bonds outstanding at end-December reached HKD703 billion.

Table 1: Size and Composition of the LCY Bond Market in Hong Kong, China

| | Amount (billion) | | | | | | Growth Rate (%) | | | | | | | |
|---------------------|------------------|------|--------|------|--------|------|-----------------|-------|--------|-------|--------|-------|--------|-------|
| | Sep-11 | | Oct-11 | | Nov-11 | | Sep-11 | | Oct-11 | | Nov-11 | | Dec-11 | |
| | HKD | US\$ | HKD | US\$ | HKD | US\$ | y-o-y | q-o-q | m-o-m | m-o-m | y-o-y | q-o-q | m-o-m | m-o-m |
| | 1,320 | 170 | 1,315 | 169 | 1,312 | 169 | 5.7 | 1.6 | (0.4) | (0.2) | 3.1 | (0.9) | (0.2) | |
| Total | 1,320 | 170 | 1,315 | 169 | 1,312 | 169 | 5.7 | 1.6 | (0.4) | (0.2) | 3.1 | (0.9) | (0.2) | |
| Government | 698 | 90 | 698 | 90 | 701 | 90 | 3.8 | 1.9 | 0.01 | 0.4 | 3.9 | 0.9 | 0.4 | |
| Exchange Fund Bills | 585 | 75 | 585 | 75 | 586 | 75 | 0.6 | 0.06 | 0.01 | 0.1 | 0.5 | 0.2 | 0.03 | |
| Exchange Fund Notes | 70.0 | 9 | 70 | 9 | 69 | 9 | (0.9) | 0.00 | 0.00 | (0.9) | (0.9) | (0.4) | 0.4 | |
| HKSAR Bonds | 42.5 | 5.5 | 43 | 5 | 46 | 6 | 117.9 | 41.7 | 0.00 | 7.1 | 100.0 | 12.9 | 5.5 | |
| Corporate | 623 | 80 | 617 | 79 | 611 | 79 | 7.8 | 1.2 | (0.9) | (0.9) | 2.2 | (2.8) | (0.9) | |

HKSAR = Hong Kong Special Administrative Region, LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:

1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY-US\$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. The amount of corporate bonds outstanding for October and November were estimated based on the compounded monthly growth rate between September 2011 and December 2011.

Source: Hong Kong Monetary Authority and Bloomberg LP.

Most of the growth in government bonds in 4Q11 can be attributed to growth in HKSAR Bonds, which expanded 100.0% y-o-y to HKD48 billion from HKD24 billion at end-December 2010. On the other hand, the stock of EFNs declined 0.9% y-o-y to HKD69 billion. EFBs grew only slightly by 0.5% y-o-y to HKD586 billion.

In November, HKD3.0 billion in 3-year HKSAR Bonds were issued; HKD2.5 billion in 5-year bonds were sold in December.

The size of LCY corporate bonds outstanding fell to HKD605.5 billion at end-December, reflecting growth of 2.2% y-o-y and a decline of 2.8% q-o-q. The top 20 non-bank corporate issuers in Hong Kong, China accounted for about 15% of total corporate bonds outstanding as of end-December (**Table 2**). Hong Kong, China's top corporate issuer of LCY bonds remained the state-owned Hong Kong Mortgage Corporation (HKMC), with bonds valued at HKD20.8 billion at end-December. Sun Hung Kai Properties (Capital Market) Ltd. was the next largest issuer with outstanding bonds of HKD12.5 billion, while CLP Power Hong Kong Financing Ltd. was in the third spot with HKD10.1 billion.

Financial firms dominated the list of the top 20 non-bank corporate issuers, accounting for all but six of the firms among the top 20. Six state-owned companies were included on the list, while 12 were privately owned. Among the companies in Table 2, only three were listed on the Hong Kong Exchange.

Policy, Institutional, and Regulatory Developments

Hong Kong Exchange Simplifies Listing Requirements for Bonds Sold to Professional Investors

On 21 October, the Hong Kong Exchange issued an amendment to the listing requirements for bonds sold to professional investors. Under the new rules, listing procedures will be made much simpler. According to the Hong Kong Exchange,

Table 2: Top 20 Non-Bank Corporate Issuers in Hong Kong, China (as of end-December 2011)

| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|--|-------------------------|--------------------------|-------------|-----------------|----------------|----------------------|
| | LCY Bonds (HKD billion) | LCY Bonds (US\$ billion) | | | | |
| 1. The Hong Kong Mortgage Corporate Ltd. | 20.75 | 2.66 | Yes | No | No | Finance |
| 2. Sun Hung Kai Properties (Capital Market) Ltd. | 12.54 | 1.61 | No | Yes | No | Finance |
| 3. CLP Power Hong Kong Financing Ltd. | 10.10 | 1.30 | No | Yes | No | Finance |
| 4. Kowloon-Canton Railway Corporation | 6.60 | 0.85 | Yes | No | No | Transportation |
| 5. MTR Corporation (C.I.) Ltd. | 5.70 | 0.73 | Yes | No | Yes | Transportation |
| 6. Airport Authority Hong Kong | 4.61 | 0.59 | Yes | No | No | Transportation |
| 7. Hongkong Electric Finance Ltd. | 4.51 | 0.58 | No | Yes | No | Finance |
| 8. The Link Finance (Cayman) 2009 Ltd. | 4.29 | 0.55 | No | Yes | No | Finance |
| 9. Swire Pacific MTN Financing Ltd. | 4.10 | 0.53 | No | Yes | No | Finance |
| 10. HKCG (Finance) Limited | 4.00 | 0.51 | No | Yes | No | Finance |
| 11. Cheung Kong Bond Finance Ltd. | 2.95 | 0.38 | No | Yes | No | Finance |
| 12. Wharf Finance Ltd. | 2.45 | 0.31 | No | Yes | No | Finance |
| 13. Cheung Kong Finance (MTN) Ltd. | 2.21 | 0.28 | No | Yes | No | Finance |
| 14. Hysan (MTN) Ltd. | 1.80 | 0.23 | No | Yes | No | Finance |
| 15. Urban Renewal Authority | 1.70 | 0.22 | Yes | No | No | Property Development |
| 16. The Hongkong Land Notes Company Ltd. | 1.19 | 0.15 | No | Yes | No | Finance |
| 17. Bauhinia MBS Ltd. | 0.86 | 0.11 | Yes | No | No | Finance |
| 18. Cathay Pacific MTN Financing Ltd. | 0.66 | 0.08 | No | No | Yes | Airlines |
| 19. Wheelock Finance Ltd. | 0.44 | 0.06 | No | No | Yes | Property Development |
| 20. Henderson Land MTN Ltd. | 0.20 | 0.03 | No | Yes | No | Finance |
| Total Top 20 Non-Bank LCY Corporate Issuers | 91.64 | 11.77 | | | | |
| Total LCY Corporate Bonds | 605.52 | 77.77 | | | | |
| Top 20 as % of Total LCY Corporate Bonds | 15.1% | 15.1% | | | | |

LCY = local currency.

Note: Based on Central Money Markets Unit data on tradeable non-bank debt securities issued and outstanding as of 1 July 2011.

Source: Hong Kong Monetary Authority.

the effect will be to shorten the listing time to 5 days after receiving the application.

Hong Kong, China's Role as Offshore Renminbi Center Expanded

On 18 January, the Hong Kong Monetary Authority (HKMA) issued new regulations making it easier for financial institutions to hold CNH. Previously, participating financial institutions were required to keep 25% of their CNH deposits in cash with the Clearing Bank and to maintain a net open position—the amount by which assets are not matched by corresponding liabilities—of 20%. Under the new rules, CNH bonds issued by the People's Republic of China will be eligible to qualify

as investments that satisfy the 25% deposit requirement. In addition, the net open position limit was reduced to 10%.

HKMA Launches Pilot Platform for Cross-Border Debt Security Investment between Malaysia and Hong Kong, China

On 13 March, HKMA, Bank Negara Malaysia (BNM), and Euroclear Bank jointly announced the launch of a pilot program allowing for cross-border investment and settlement of debt securities. Through the pilot platform, investors in Hong Kong, China and Malaysia can buy and hold the LCY debt securities of each country on a delivery-versus-payment (DVP) basis.